# UNITED STATES BANKRUPTCY COURT EASTERN DISTRICT OF WISCONSIN

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JAMES E. PUTMAN and CHRISTINE A. PUTMAN,

Case No. 10-32980

Adversary No. 10-2484

Chapter 7

Debtors.

TONY P. TRIMBLE, TRUSTEE OF TONY P. TRIMBLE REVOCABLE TRUST AGREEMENT DATED SEPTEMBER 4, 1998,

Plaintiff,

V.

JAMES E. PUTMAN,

Defendant.

### MEMORANDUM DECISION ON PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

The plaintiff, Tony P. Trimble, Trustee of Tony P. Trimble Revocable Trust Agreement Dated September 4, 1998 (hereinafter "Trimble"), filed an adversary proceeding under 11 U.S.C. § 523(a)(2), (a)(4), (a)(6), and (a)(19) seeking a determination that the obligation owed by the defendant, James E. Putman, is excepted from the latter's discharge. The plaintiff filed a motion for summary judgment, which was opposed by the defendant, and both parties filed briefs in support of their respective positions.

This is a core proceeding under 28 U.S.C. § 157(b)(2)(I), and the Court has jurisdiction under 28 U.S.C. § 1334. The following constitutes the Court's findings of facts and conclusions of law pursuant to Fed. R. Bankr. P. 7052. For the reasons stated below, the plaintiff's motion

for summary judgment is denied.

#### BACKGROUND

The debtor, James Putman, was the founder, majority owner, and Chief Executive Officer of Wealth Management LLC, a registered investment advisory firm located in Appleton, Wisconsin. Wealth Management provided financial planning for families and individuals and also served as General Partner or Managing Member for six unregistered investment pools. At the time of the alleged wrongdoings, the debtor was CEO and Simone Fevola was President and Chief Investment Officer of Wealth Management.

On May 20, 2009, the Securities and Exchange Commission filed a complaint against several parties, including Wealth Management LLC, James Putman, and Simone Fevola, with the Gryphon Fund as one of the relief defendants, alleging violations of Section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a), and Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 9240.10b-5 (E.D. Wis. Civil Action No. 09-CV-506). According to the SEC complaint, Putman and Fevola engaged in a kickback scheme through which each accepted at least \$1.24 million in undisclosed payments derived from certain investments made by the Wealth Management Funds, while continuing to cause clients to invest in the funds. The complaint also alleged that Wealth Management, Putman and Fevola breached their fiduciary duties and engaged in fraud by misrepresenting the safety and stability of the funds and by placing their clients into the unsuitable investments. A receiver was appointed and the assets of Wealth Management and the investment pools were frozen. Simone

<sup>&</sup>lt;sup>1</sup>The investment pools/funds were WML Gryphon Fund LLC; WML Watch Stone Partners, L.P.; WML Pantera Partners, L.P.; WML Palisade Partners, L.P.; WML L3, LLC; and WML Quetzal Partners, L.P.

Fevola consented to final judgment without admitting or denying the alleged violations. The judgment included disgorgement of profits gained as a result of the alleged conduct. (E.D. Wis. Civil Action No. 09-CV-506, Final Judgment dated March 4, 2010). The district court entered default judgments against Wealth Management and each of the Relief Defendants for violation of the anti-fraud provisions of the federal securities laws and ordered disgorgement of profits as a result of the alleged conduct. (E.D. Wis. Civil Action No. 09-CV-506, Final Judgment dated March 4, 2010). The causes of action against the debtor in the SEC litigation are still pending.

On June 10, 2009, Trimble, the plaintiff in this adversary proceeding, filed a complaint with the United States District Court in Minnesota alleging that Putman had committed securities fraud in violation of Section 10(b) of the Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78j(b), and Minnesota Statutes § 80A.68. (D. Minn. Civil Action No. 09-1367). Trimble sought recovery of \$700,000.00 he invested with, plus advisory fees paid to, Wealth Management. The complaint alleged that Trimble made the investment based on Putman's misrepresentations, including the following: (1) Putman misrepresented the safety and stability of the Gryphon fund and induced Trimble to twice invest in Gryphon, even though such investment was unsuitable for Trimble; (2) Trimble was induced to invest in Gryphon based on other representations that were knowingly false or made with reckless disregard for the truth; (3) Trimble justifiably relied upon the false and misleading representations and/or omissions of Putman in connection with investments in Gryphon; and (4) Trimble would not have made the investments absent such false representations and/or omissions. (D. Minn. Civil Action No. 09-CV-1367, Complaint ¶ 6, 82, 83).

One June 16, 2009, the Minnesota District Court proceeding was stayed by the

Temporary Order Granting Receiver's Motion to Stay Ancillary Litigation entered by the Eastern District of Wisconsin District Court in the Securities and Exchange Commission litigation. That stay was lifted on April 30, 2010, giving Putman a May 19, 2010, deadline to file an Answer in the Trimble action.

After Putman failed to timely answer the complaint in the securities fraud action, Trimble filed an Application for Entry of Default and obtained a Clerk's Entry of Default on May 29, 2010. According to Putman, he filed an Answer to the Complaint on May 26, 2010. And, on the face of it, it was mailed to the plaintiff. His Answer is not on the district court docket, however.<sup>2</sup>

Trimble then filed a motion for default judgment under Fed. R. Civ. P. 55(b)(2) on June 10, 2010. Putman failed to respond to Trimble's motion for default judgment, and he also failed to appear at the hearing on the motion for default held on July 28, 2010. (*See* D. Minn. Civil Action. No. 09-CV-1367, Findings of Fact, Conclusions of Law, and Order for Judgment, dated August 2, 2010<sup>3</sup>). The Minnesota District Court found Trimble was entitled to the entry of a default judgment against Putman in the amount of \$857,001.04,<sup>4</sup> due to the latter's failure to

<sup>&</sup>lt;sup>2</sup>The heading of Putman's Answer (which he attached to his response in this proceeding) includes what appears to be a docket stamp similar to Trimble's Application for Entry of Default, which, if the Answer had in fact been mailed to the Minnesota District Court, may have caused the court clerk case manager to think it was a previously-filed document. (In the plaintiff's response, he does not argue that Putman never answered the complaint, rather, that he failed to *timely* answer the complaint.) The accuracy of the district court docket is further put into question by the missing court minutes from the default hearing (*see* footnote 3).

<sup>&</sup>lt;sup>3</sup>Although Court Minutes for the July 28, 2010, default hearing are not reflected on the official court docket, this Court assumes a hearing took place, because it is referred to in the District Court's Order for Judgment.

<sup>&</sup>lt;sup>4</sup>The award included \$21,541.91 in attorney's fees and \$150,058.17 in prejudgment interest under state law.

timely answer or otherwise respond to the complaint's allegations that "he engaged in transactions, acts, practices, or courses of business constituting securities fraud under federal and Minnesota law," as well as his failure to respond to the motion for default. (D. Minn. Civil Action. No. 09-CV-1367, Findings of Fact, Conclusions of Law, and Order for Judgment, dated August 2, 2010). Putman neither appealed nor requested reconsideration of the judgment. Four days later, on August 6, 2010, Putman filed a voluntary chapter 7 petition.

#### **ARGUMENTS**

The plaintiff argues the Minnesota securities fraud judgment is nondischargeable pursuant to 11 U.S.C. § 523(a)(19). The final judgment is for the debtor's violation of federal and state securities laws and fraud, deceit, or manipulation in connection with the purchase or sale of a security. The default judgment satisfies the elements of section 523(a)(19) under the doctrine of issue preclusion. Because the complaint and other documents submitted in obtaining the default judgment provided evidence that the securities fraud issues were necessarily decided, those issues need not be actually litigated in order to have a binding effect under federal and Minnesota law. *See In re Tills*, 419 B.R. 444 (Bankr. S.D. Cal. 2009); *In re Gibbons*, 289 B.R. 588 (S.D.N.Y. 2003); *In re Sword*, Case No. 05-50608 (M.D. Pa.) (unpublished); *Ellis v. Minneapolis Comm'n on Civil Rights*, 319 N.W.2d 702, 704 (Minn. 1982); *Herreid v. Deaver*, 259 N.W. 189, 191 (Minn. 1935).

The defendant opposes summary judgment and argues he was unaware of any fraudulent activity in any of Wealth Management's sub-managed funds. Trimble was an investor in the WML Gryphon Fund LLC, and not a creditor of Wealth Management LLC or Putman, personally. According to Putman, Trimble was a sophisticated investor and was aware of the

fund's investment strategy and risks before he made his first investment. The investment losses were the result of the global economic credit and liquidity crisis in 2008 and 2009, causing the inability of Gryphon to raise cash for distribution to investors. Trimble should seek compensation from the receiver who currently is in control of millions of dollars in the accounts of Wealth Management and the Wealth Management Funds. Putman argues he was defending the SEC litigation without counsel and the default judgment was entered against him because he answered the complaint after the required date. He intends to appeal that judgment if he is able to.

#### DISCUSSION

## Summary Judgment Standards

To prevail on a motion for summary judgment the moving party must show there is no genuine issue of material fact and he or she is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c); *Celotex Corp. v. Catrett*, 477 U.S. 317, 323, 106 S.Ct. 2548 (1986). "Material facts" are those facts which "might affect the outcome of the suit," and a dispute about a material fact is "genuine" if a reasonable finder of fact could find in favor of the nonmoving party. *See Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). Summary judgment is appropriate where a party has failed to make "a showing sufficient to establish the existence of an element essential to that party's case and on which the party will bear the burden of proof at trial." *Celotex*, 477 U.S. at 322-23. A party opposing summary judgment may not rest upon the mere allegations or denials of the adverse party's pleading, but must set forth specific facts showing that there is a genuine issue for trial. Fed. R. Civ. P. 56(e); *Heft v. Moore*, 351 F.3d 278, 282-83 (7th Cir. 2003). Any doubt as to the existence of a material

fact is to be resolved against the moving party. Anderson, 477 U.S. at 255.

In viewing the facts presented on a motion for summary judgment, a court must construe all facts in a light most favorable to the non-moving party and draw all legitimate inferences in favor of that party. *See NLFC, Inc. v. Devcom Mid-America, Inc.*, 45 F.3d 231, 234 (7<sup>th</sup> Cir. 1995). A court's role is not to evaluate the weight of the evidence, to judge the credibility of the witnesses, or to determine the truth of the matter, but instead to determine whether there is a genuine issue of triable fact. *See Anderson*, 447 U.S. at 249-50.

Applicable Law Governing Doctrine of Issue Preclusion

It has generally been held that the applicability of the doctrine of res judicata or collateral estoppel in a diversity action in a federal court is governed by state law, at least where the issues involved in the prior judgment were issues of state law. However, there is authority for the view that the applicability of the doctrine in a diversity action is governed by federal law, and not by state law, where the issues involved in the prior judgment were issues of federal law. *See*Romualdo P. Eclavea, *State or Federal Law as Governing Applicability of Doctrine of Res Judicata or Collateral Estoppel in Federal Court Action*, 19 A.L.R. Fed. 709 (originally published in 1974). In the underlying case we have diversity of citizenship between the two parties and issues of both federal and state law, with no distinction made in the record as to either acts or damages. The District Court for the District of Minnesota found that Timble was entitled to the entry of Judgment against Putman due to the latter's failure to timely answer the Complaint "alleging that he engaged in transactions, acts, practices, or courses of business constituting securities fraud under federal and Minnesota law," or respond to the Motion for Default. (D. Minn. Civil Action. No. 09-CV-1367, Findings of Fact, Conclusions of Law, and

Order for Judgment, dated August 2, 2010). Again, no distinction is made as to breaches of federal law or state law leading to any apportionment of damages. Indeed, the district court order never made specific findings on the underlying alleged facts or law in the complaint, only that the defendant was in default and wrongdoing was alleged. Apparently, the same conduct can result in damages under federal and state law, so the court will consider the standards under both federal and Minnesota law for issue preclusion.

The Supreme Court "has repeatedly recognized ... that the concept of collateral estoppel cannot apply when the party against whom the earlier decision is asserted did not have a 'full and fair opportunity' to litigate that issue in the earlier case." *Allen v. McCurry*, 449 U.S. 90, 95, 101 S.Ct. 411, 415 (1980) (citing *Montana v. United States*, 440 U.S. 147, 153, 99 S.Ct. 970, 973 (1979); *Blonder-Tongue Laboratories, Inc. v. University of Illinois Foundation*, 402 U.S. 313, 328-329, 91 S.Ct. 1434, 1443 (1971)). According to the Court, "[i]ssue preclusion bars 'successive litigation of an issue of fact or law actually litigated and resolved in a valid court determination essential to the prior judgment,' even if the issue recurs in the context of a different claim." *Taylor v. Sturgell*, 553 U.S. 880, 128 S.Ct. 2161 (2008) (citing *New Hampshire v. Main*, 532 U.S. 742, 748-749, 121 S.Ct. 1808 (2001)).

Although the standards vary slightly among the federal circuits, in the Eighth Circuit, issue preclusion has five elements: (1) the party sought to be precluded in the second suit must have been a party, or in privity with a party, to the original lawsuit; (2) the issue sought to be precluded must be the same as the issue involved in the prior action; (3) the issue sought to be precluded must have been actually litigated in the prior action; (4) the issue sought to be precluded must have been determined by a valid and final judgment; and (5) the determination in

the prior action must have been essential to the prior judgment. *Ginters v. Frazier*, 614 F.3d 822, 826 (8<sup>th</sup> Cir. 2010) (citing *Robinette v. Jones*, 476 F.3d 585, 589 (8<sup>th</sup> Cir. 2007).

In this case, the third element – actual litigation of the issue sought to be precluded – has clearly not been met. Mr. Putman was a party to the original lawsuit and the issue sought to be precluded here is the same as the issue involved in the prior action. In spite of Mr. Putman's assertions that he may appeal the judgment, the issue sought to be precluded was determined by a final judgment that is in effect right now. The appeal period expired, and the default judgment is final.

Because the district court judgment was entered on default and not actually litigated, there was no prove-up of the allegations, the judgment of the district only referred to "allegations" and not findings of fact, and the only finding was default by the defendant, summary judgment cannot be granted on the judgment against the debtor relating to the federal securities law violations.

The district court also entered default judgment against Putman for violation of Minnesota securities laws. In Minnesota, for collateral estoppel to apply, all of the following prongs must be met: (1) the issue must be identical to one in a prior adjudication; (2) there was a final judgment on the merits; (3) the estopped party was a party or was in privity with a party to the prior adjudication; and (4) the estopped party was given a full and fair opportunity to be heard on the adjudicated issue. *Care Inst., Inc.-Roseville v. County of Ramsey*, 612 N.W.2d 443, 448 (Minn. 2000). Although Minnesota does not required the matter be actually litigated, the state supreme court has "observed that neither res judicata nor collateral estoppel is to be rigidly applied. Instead, the focus is on whether their application would work an injustice on the party against whom the doctrines are urged." *Hauschildt v. Beckingham*, 686 N.W. 2d 829, 837

(Minn. 2004) (citations omitted).

What constitutes "a full and fair opportunity to be heard on the adjudicated issue" is a slippery concept. One Minnesota appellate court found that a trial court did not err in applying collateral estoppel to claims determined in a previous default judgment. *Roberts v. Flanagan*, 410 N.W.2d 884, 886-87 (Minn. App. 1987). However, contrary to its ultimate finding, the *Roberts* court had also noted that "collateral estoppel ... operates only as to matters actually litigated, determined by, and essential to a previous judgment." *Id.* at 886 (citing *Roseberg v. Steen*, 363 N.W.2d 102, 105 (Minn. App.1985)). Notably, perhaps, the lower court had actually made a finding that the defendant had engaged in the actions alleged by the plaintiff. *Id.* at 885.

According to another Minnesota appellate court, "collateral estoppel operates only as to matters actually litigated, determined by, and essential to a previous judgment." *Tokheim v. Pollard*, Case No. C1-00-1937, 2001 WL 1035020 (Minn. App. Sept. 11, 2001) (unpublished) (citing *In re Application of Hofstad to Register Title to Certain Land*, 376 N.W.2d 698, 700 (Minn. App. 1985)). Because default judgments were entered in the *Tokheim* case after the defendants failed to participate in the action, the appellate court determined the issue sought to be precluded had not been an "essential" matter to the judgment and had not been "actually litigated." *Cf. Sachs v. Jenista*, 210 N.W.2d 45, 46–47 (Minn. 1973) (proponent of collateral estoppel must establish "that the precise question was in fact presented and necessarily determined").

The bankruptcy court in *In re Brandl*, 179 B.R. 620, 626 (Bankr. D. Minn. 1995), determined that under Minnesota law "a default judgment may be given full preclusive effect as to all issues pleaded in the underlying complaint, as long as the proponent satisfies all of the

other elements of collateral estoppel as to those issues," most importantly, the defendant had been given a "full and fair opportunity" to interpose a defense in the prior case. In that underlying case, the debtor had failed to timely answer the plaintiff's complaint and judgment was docketed without any separate findings of fact and conclusions of law. The bankruptcy court found the default judgment was entitled to preclusive effect under Minnesota law and entered a judgment of nondischargeability against the debtor. However, as set forth above, this Court does not believe the Minnesota courts have consistently applied the doctrine of collateral estoppel to default judgments.

This case, in particular, is not one in which the default judgment was rendered by the district court after making specific findings regarding the debtor's conduct. Although the district court's Findings of Fact and Conclusions of Law were "[b]ased on the Motion papers, arguments of counsel, and all of the files, records and proceedings herein," including the declaration of the plaintiff, the Order for Judgment appears to have been entered solely due to a procedural default, or what is also referred to as a "true default." Federal courts are unlikely to apply collateral estoppel to true defaults and, apparently, Minnesota courts may not be so inclined in all cases, as well.

There are circumstances in this case leading to the default judgment that indicate it would

<sup>&</sup>lt;sup>5</sup>Courts have struggled with whether or not preclusive effect should be given to true default judgments, which are defined as judgments that have been entered solely because a defendant failed to file an answer or take any steps to defend an action, and no material facts are established by proof. *See, e.g.*, Howard J. Steinberg, *Issue Preclusion*, Bankr. Lit. § 13:89 (updated June 2010); Nancy C. Dreher, *Exceptions to Discharge - Procedure for Obtaining Determination of Dischargeability of Debt*, Bankr. L. Manual § 8A:25 (updated Nov. 2010); Francis C. Amendola, et al., *Judgment by Default*, CJS Judgments § 253 (updated March 2011); E.H. Schopler, *Doctrine of Res Judicata as Applied to Default Judgments*, 77 A.L.R.2d 1410 (originally published 1961).

be inequitable to apply the doctrine of collateral estoppel, even under the sometimes looser Minnesota standards. For example, the debtor's answer and letter to the Magistrate Judge are not on the official court docket; there are no court minutes from the hearing on the motion for default and no other indication of a prove-up; and there are no specific findings on the facts and law by the district court, especially no specific finding of a violation of securities law that would make the judgment nondischargeable under 11 U.S.C. § 523(a)(19). Furthermore, the fact that the debtor filed this bankruptcy case four days after the judgment was signed indicates he did not intend to contest the merits in that case, i.e., actually litigate it, because it would soon become a bankruptcy matter. He would have had no motivation to contest the merits at that time. He has, however, contested the merits in this adversary proceeding. Accordingly, the Court declines to apply collateral estoppel to the Minnesota judgment with respect to any of the elements of nondischargeability under 11 U.S.C. § 523(a).

### **CONCLUSION**

For the reason stated above, the Court denies the plaintiff's motion for summary judgment. A separate order will be entered accordingly and further proceedings will be scheduled.

June 2, 2011

Margaret Dee McGarity United States Bankruptcy Judge